Supreme Court of the United States.

OCTOBER TERM, 1977.

No. 77-334.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF BOSTON, ET AL.,

APPELLANTS,

v.

STATE TAX COMMISSION, ET AL.,

APPELLEES.

ON APPEAL FROM THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.

Brief in Opposition to Motion to Dismiss.

CHESTER M. HOWE,
MAXWELL D. SOLET,
GASTON SNOW & ELY BARTLETT,
One Federal Street,
Boston, Massachusetts 02110.
(617) 426-4600
Attorneys for the Appellants.

ADDISON C. GETCHELL & SON, INC., THE LAWYERS' PRINTER, BOSTON

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Appellants oppose Appellees' Motion to Dismiss the appeal in this case for the reasons stated below.

A. Discrimination.

The United States Court of Appeals for the First Circuit struck down the deposits element of the Massachusetts tax because it was deliberately discriminatory. The Massachusetts Supreme Judicial Court sustained the income-based portion of the tax, despite its finding of adverse discrimina-

tion against Federal associations on the grounds that Massachusetts was not the source of the discrimination and that a "substantial competitive disadvantage" had not been shown. Thus the existence of adverse discrimination against Federal associations has been found conclusively. The issue is whether the discrimination may be excused.

Massachusetts subtly seeks to avoid the issue by arguing that no factual discrimination exists. The argument is not only too late but also baseless. Omitted from Appellees' Brief is the fact that State cooperative banks received larger aggregate deductions for additions to reserves than did Federal associations in six out of the seven years following enactment of the statute in question (A. 229-231). State savings banks received larger aggregate deductions in four of the seven years and equal deductions in one year, as noted by Appellees. The argument that the record does not support the finding of discrimination is without merit. Therefore, the burden is on the Appellees to show that there is "just reason" for such discrimination and that it does not create "an unequal and unfriendly competition" with the Federal associations. *Michigan National Bank* v. *Michigan*, 365 U.S. 467, 473 (1961).

Massachusetts seems to argue that any differences in allowable deductions is justified since the deductible amounts represent restricted funds. Appellees state:

> The essential point, which is obscured by the associations' arguments, is that the guaranty fund is a portion of surplus which, by law, is not available either for distribution to the shareholders (depositors) or for investment.

Appellees' Brief at 16. That statement is wrong. The portion of surplus represented by the guaranty fund is fully available for investment. The only statutory limitation on

such a fund is that it may not be used for distributions to shareholders or depositors. M.G.L. c. 168, § 59 (defining "net income" available for dividends); M.G.L. c. 170, § 37 (describing procedure for distribution of "net profits"); 12 C.F.R. § 563.11(a) (prohibiting dividends or interest from insurance reserve account). In accounting terms, a guaranty fund constitutes a segregation of the surplus shown on the liabilities side of the balance sheet, but it has no effect on the mix of items shown on the assets side. In contrast, the liquidity reserve required of cooperative banks must be held in specific sorts of investments. M.G.L. c. 170, § 40.

Finally, Massachusetts argues that the discrimination contained in the income-based measure of the tax is purged of taint by the earlier holding of the Court of Appeals that the deposits portion of the tax is discriminatory and therefore invalid as to the Federal associations. This argument was not raised in the courts below. Further, there is no logic to preferring one discriminatory tax over the other. Surely, the discrimination inherent in the income-based portion of the tax is made no less offensive by the holding that the deposits tax enacted by the same statute is deliberately discriminatory rather than nondiscriminatory. The order in which the two elements of the tax are addressed by the courts cannot alter the validity of either.

B. Nomenclature.

In its discussion of the nature of the tax, Massachusetts again appears to alter the focus of the inquiry. The issue is not whether the tax can be nominally characterized as an income-based tax, as was done by the Court of Appeals or as a franchise tax, as was done by the Supreme Judicial Court. Either "label" satisfies 12 U.S.C. § 1464(h) on its face. The question, properly framed, is whether the statute

actually imposes an income tax or a franchise tax under Federal law. Can a tax which denies a deduction for the largest single annual expense—payments to depositors—while allowing a deduction for an element unrelated to income—additions to reserves—be defined as an income tax? Can a tax which fails to provide an apportionment mechanism, thereby giving no recognition to the fact that the depositors and sources of revenue of Federal associations may be substantially extraterritorial to Massachusetts, properly reflect the value of the exercise of the franchise in the state? Massachusetts does not address these questions.

C. Extraterritorial Income.

In *Brady* v. *John Hancock Mutual Life Insurance Company*, —— Miss. ——, 342 So. 2d 295 (1977), the Supreme Court of Mississippi held that that state had jurisdiction to tax interest income of a non-resident corporation based upon the fact that the loans in question were secured by real estate within the taxing state and the security interests were recorded there, even in cases in which the non-resident had purchased mortgage loans from independent contractors and had held and serviced them outside the state. This Court recently dismissed the appeal in the cited case. 46 U.S.L.W. 3187 (Dkt. No. 76-1688, October 3, 1977).

The Massachusetts Supreme Judicial Court acknowledged that the Federal associations invest a substantial portion of their funds in mortgage loans secured by non-Massachusetts real estate. Over $300,000,000 of revenues were received by the Federal associations from out-of-state sources through 1974 (A. 234). Federal associations border on all five neighboring states (A. 3-12), and all Federal associations have power to make direct mortgage loans outside Massachusetts. Detailed evidence as to the out-of-state

mortgage activity of each of the thirty-four Appellants is not necessary in a declaratory action such as this in which the liability of individual institutions is not in question.

Conclusion.

Appellees have not stated adequate reasons for dismissing the appeal in this case. The Federal questions presented are substantial, and the record is entirely sufficient.

Appellees' motion should be denied, probable jurisdiction should be noted, and the decision of the Supreme Judicial Court of Massachusetts should be reversed.

Respectfully submitted,

CHESTER M. HOWE,
MAXWELL D. SOLET,
GASTON SNOW & ELY BARTLETT,
One Federal Street,
Boston, Massachusetts 02110.
(617) 426-4600
Attorneys for the Appellants.